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Date:

August 26, 2010

LEGEND:

X =

Y =

Z =

Date 1 =

Date 2 =

Dear :

This ruling is in response to X's Date 1 request for a ruling on behalf of Y under §1.381(c)(4)-1(d)(1) of the Income Tax Regulations. X requested on behalf of Y that the Commissioner determine the appropriate methods of accounting for non-*de minimis* and *de minimis* original issue discount ("OID") associated with non-residential loans. X asked that Y be permitted to use the constant yield method of accounting for non-*de minimis* OID associated with non-residential loans, as stated in section 1272(a) of the Internal Revenue Code and §1.1272-1(b), and the loan-by-loan principal payment method for *de minimis* OID associated with non-residential loans, as stated in §1.1273-1(d)(5).

FACTS

On Date 2, two corporations, Y and Z, merged in a transaction that X represents qualifies as a tax-free transfer to which the provisions of section 381(a) apply. Specifically, Z merged into Y in a transaction under section 368(a)(1)(A), with Y being the surviving corporation. After the transfer, Y did not operate Z's trades or businesses as separate and distinct from its own.

Y and Z charge certain upfront fees upon the origination of non-residential loans. The fees include points and origination fees ("Fees"). Borrowers may pay Fees in cash at the time the loan is originated, or Y and Z may finance Fees by reducing the issue price of the loan. X represents that the Fees are for the use or forbearance of money and are not charged for any property or services provided by Y or Z. X represents that the Fees do not include payments received by Y or Z for reimbursement of closing costs (*i.e.*, appraisal fees, documentation costs, or settlement fees), commitment fees received from potential borrowers, or other payments received that do not constitute consideration for the use or forbearance of money.

Under its current method of accounting for the Fees, Y recognizes the income from the Fees in taxable income upon receipt under the current inclusion method of accounting. Z, however, treated income from Fees as OID. Under its method of accounting for the Fees, Z used a method of accounting for OID that approximated the constant yield method of accounting for Fees that resulted in more than a *de minimis* amount of OID. Z also used a method of accounting for *de minimis* OID that approximated the loan-by-loan principal payment method of accounting for the Fees.

After the merger, X represents that the principal method of accounting, determined under §1.381(c)(4)-1(c), was Y's current inclusion method. X represents that this method, however, does not clearly reflect income under section 446(b). Therefore, because Y may not use the current inclusion method after the Date 2 transfer, the Commissioner must determine the appropriate method of accounting under §1.381(c)(4)-1(d)(1)(i).

LAW AND ANALYSIS

Section 381(a)(2) requires the corporation that acquires the assets of another corporation in a transfer to which section 361 applies (if in connection with a reorganization described in section 368(a)(1)(A), *inter alia*), to succeed to and take into account the items described in section 381(c) of the transferor corporation. See *also*, §§1.381(a)-1(a); 1.381(a)-1(b)(1)(ii).

Section 381(c)(4) requires the acquiring corporation to use the method of accounting used by the transferor corporation on the date of transfer unless the transferor corporation and the acquiring corporation used different methods. If the transferor and acquiring corporations used different methods, the acquiring corporation

must use the method or combination of methods of accounting adopted pursuant to regulations prescribed by the Secretary. See *also* §1.381(c)(4)-1(a)(1)(i).

Section 1.381(c)(4)-1(b)(3)(ii) states that if, after the date of transfer, any of the trades or businesses of the parties to a transaction described in section 381(a) are not operated as separate and distinct trades or businesses within the meaning of §1.446-1(d), then, to the extent that the parties to the transaction employed different methods of accounting on the date of transfer, the acquiring corporation must adopt the principal method of accounting, as determined under §1.381(c)(4)-1(c), or the method of accounting determined in accordance with §1.381(c)(4)-1(d), whichever is applicable.

Section 1.381(c)(4)-1(c)(1) requires the acquiring corporation to use the principal method of accounting (as determined under §1.381(c)(4)-1(c)(2)) if it clearly reflects the income of the acquiring corporation. Section 1.381(c)(4)-1(d)(1)(i) states that if the principal method of accounting does not clearly reflect income and therefore cannot be used by the acquiring corporation, the acquiring corporation must request that the Commissioner determine the appropriate method of accounting.

Section 1.381(c)(4)-1(d)(1)(iii) provides that the increase or decrease in tax resulting from the change from the method of accounting previously used by any of the corporations involved shall be taken into account by the acquiring corporation. The adjustments necessary to reflect such change and such increase or decrease in tax shall be determined and computed in the same manner as if, on the date of transfer, each of the several corporations that were not using the method or combination of methods of accounting adopted pursuant to §1.381(c)(4)-1(d)(1)(i) had initiated a change in accounting method.

Section 1.381(a)-1(b)(2) provides that the acquiring corporation is that corporation which ultimately acquires the assets transferred by the transferor corporation in a transaction to which section 381(a)(2) applies.

Section 1.381(b)-1(b)(1) defines the date of transfer as that day on which are transferred all those properties of the transferor corporation which are to be transferred pursuant to the reorganization.

Section 1.381(c)(4)-1(a)(2) defines the term “method of accounting” as having the same meaning as that provided under section 446 and the regulations thereunder.

Under §1.1273-2(g), a payment from the borrower to the lender made incident to a lending transaction (other than a payment for property or for services provided by the lender) reduces the issue price of the loan, thereby creating or increasing OID on the loan.

If a loan has more than a *de minimis* amount of OID, the OID is included in income over the term of the loan based on a constant yield method. See section 1272(a) and §1.1272-(b). If a loan has a *de minimis* amount of OID, the *de minimis* OID is included in income as stated principal payments are made on the loan. The amount includible in income with respect to each principal payment equals the product of the total amount of *de minimis* OID on the loan and a fraction, the numerator of which is the amount of the principal payment made, and the denominator of which is the stated principal amount of the loan. See §1.1273-1(d)(5).

CONCLUSION

For Fees related to non-residential loans that result in a non-*de minimis* amount of OID, Y must use the constant yield method of accounting in accordance with section 1272(a) and §1.1272-1(b)(1). Additionally, for Fees related to non-residential loans that result in a *de minimis* amount of OID, Y must use the loan-by-loan principal payment method in accordance with §1.1273-1(d)(5).

The information and the statements and representations made in the request for this ruling form a material basis upon which this ruling is issued. The facts upon which this ruling is based are subject to verification by the director.

No opinion is expressed as to the tax treatment of the transaction under the provisions of any other sections of the Code and regulations that may be applicable thereto or the tax treatment of any condition existing at the time of, or effect resulting from, the transaction that is not specifically set forth by this ruling. Specifically, no opinion is provided as to whether the Date 2 transfer qualifies as a tax-free transaction to which section 381(a) applies. Further, no opinion is expressed as to Y's use of the current inclusion method of accounting prior to Date 2.

A copy of this ruling should be attached to the federal income tax return for the taxable year in which the transaction covered by this ruling is consummated. Pursuant to a power of attorney on file with this office, a copy of this ruling is being sent to X's authorized representatives.

This ruling is directed only to X, who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,

Roy A. Hirschhorn
Chief, Branch 6
Office of Associate Chief Counsel
(Income Tax & Accounting)